INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statutes and regulations involved	2
Statement	2
Specification of errors to be urged	4
Summary of argument	5
Argument:	
I. The purpose and effect of the challenged statute were merely to correlate the deductions with the limited classes of income to be taxed. This method of exercising an admitted power does not convert the tax into a direct tax which is invalid	7
II. The statute allows the deductions upon a condition. Respondent will not be heard to rely upon the grant of the allowances and at the same time to assail the condition	28
Conclusion	34
Appendix A (statutes and regulations)	35
Appendix B (committee hearings)	39

CITATIONS

Cases:	
Anderson v. *Forty-Two Broadway Co.*, 239 U.S. 69	15
Barclay & Co. v. *Edwards*, 267 U.S. 442	18
Block v. *Hirsh*, 256 U.S. 135	19
Blodgett v. *Silberman*, 277 U.S. 1	24
Booth Fisheries v. *Industrial Comm.*, 271 U.S. 208	29
Boston & Maine R. Co. v. *Armburg*, 285 U.S. 234	28
Bromley v. *McCaughn*, 280 U.S. 124	24
Burnet v. *Thompson Oil & Gas Co.*, 283 U.S. 301	15
Champlin Refining Co. v. *Corporation Commission*, 286 U.S. 210	33
Clarke v. *Haberle Brewing Co.*, 280 U.S. 384	15
Columbus Ry. & Power Co. v. *Columbus*, 249 U.S. 399	30
Commissioner v. *Lafayette Life Ins. Co.*, 67 F. (2d) 209	9
Commissioner v. *Rockford Life Ins. Co.*, 67 F. (2d) 213	9
Denman v. *Slayton*, 282 U.S. 514	16, 20
Educational Films Corp. v. *Ward*, 282 U.S. 379	24
Electric Co. v. *Dow*, 166 U.S. 489	29
Evans v. *Gore*, 253 U.S. 245	21

Cases—Continued.

	Page
Flint v. *Stone Tracy Co.*, 220 U.S. 107	18, 19, 24, 25
Fox River Co. v. *R.R. Comm.*, 274 U.S. 651	30
Frost v. *Corporation Commissioner*, 278 U.S. 515	28, 32
Grand Rapids & Indiana Ry. Co. v. *Osborn*, 193 U.S. 17	30
Great Falls Mfg. Co. v. *Att'y General*, 124 U.S. 581	29
Greiner v. *Lewellyn*, 258 U.S. 384	24
Hamilton Co. v. *Massachusetts*, 6 Wall. 632	18
Hancock Mutual Life Ins. Co. v. *Warren*, 181 U.S. 73	30
Home Ins. Co. v. *New York*, 134 U.S. 594	18
Horn Silver Mining Co. v. *New York*, 143 U.S. 305	30
Income Tax Cases, 148 Wis. 456	17
Insurance Co. v. *Glidden Co.*, 284 U.S. 151	28
Internat'l & G. N. Ry. Co. v. *Anderson Co.*, 246 U.S. 424	30
Interstate Railway Co. v. *Massachusetts*, 207 U.S. 79	30
Keusch, Otto, v. *Commissioner*, 23 B.T.A. 216, dismissed, 60 F. (2d) 481, certiorari denied, 287 U.S. 641	16
Lewis v. *Commissioner*, 47 F. (2d) 32	16
Metropolis Theatre Co. v. *Chicago*, 228 U.S. 61	22
Miles v. *Graham*, 268 U.S. 501	21
Miller v. *Milwaukee*, 272 U.S. 713	18
Nat'l Life Ins. Co. v. *United States*, 277 U.S. 508	6, 12, 20, 22, 24
O'Gorman & Young, Inc., v. *Hartf'd Ins. Co.*, 282 U.S. 251	27
Pacific Co. v. *Johnson*, 285 U.S. 480	18, 24
Patton v. *Brady, Executrix*, 184 U.S. 608	25
Peck & Co. v. *Lowe*, 247 U.S. 165	18
Pierce Oil Co. v. *Phoenix Rfg. Co.*, 259 U.S. 125	30
Provident Institution v. *Massachusetts*, 6 Wall. 611	18
Railway Express Co. v. *Virginia*, 282 U.S. 440	30
Rockford Life Insurance Co. v. *Commissioner*, No. 722 October Term, 1933	9, 15, 34
Shaffer v. *Carter*, 252 U.S. 37	17, 18
Society for Savings v. *Coite*, 6 Wall. 594	18
Southern Utilities Co. v. *Palatka*, 268 U.S. 232	30
St. Louis Co. v. *Prendergast Co.*, 260 U.S. 469	29
Stanton v. *Baltic Mining Co.*, 240 U.S. 103	15
Underwood T'writer Co. v. *Chamberlain*, 254 U.S. 113	18
United Gas Co. v. *R.R. Comm'n*, 278 U.S. 300	29
U.S. Glue Co. v. *Oak Creek*, 247 U.S. 321	18
Utah Power & Light Co. v. *Pfost*, 286 U.S. 165	33
Von Baumbach v. *Sargent Land Co.*, 242 U.S. 503	15
Wall v. *Parrott Silver & Copper Co.*, 244 U.S. 407	29
Waters-Pierce Oil Co. v. *Texas*, 177 U.S. 28	30
Wight v. *Davidson*, 181 U.S. 371	29
Willcuts v. *Bunn*, 282 U.S. 216	24
Statutes:	
Revenue Act of 1921, c. 136, 42 Stat., 227, 261, 262:	
Sec. 243	35
Sec. 244	35
Sec. 245	35

Statutes—Continued. Page

Revenue Act of 1924, c. 234, 43 Stat. 253:
Sec. 208 (U.S.C., Title 26, Sec. 939) 16
Sec. 243 (U.S.C., Title 26, Sec. 1001) 37
Sec. 244 (U.S.C., Title 26, Sec. 1003) 37
Sec. 245 (U.S.C., Title 26, Sec. 1004) 37
Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 245 (U.S.C. App., Title 26, Sec. 1004) 13
Revenue Act of 1928, c. 852, 45 Stat. 791, Sec. 203 (U.S.C. Sup. V, Title 26, Sec. 115) 13
Revenue Act of 1932, c. 209, Sec. 203 (b), 47 Stat. 169 (U.S.C. Sup. VI, Title 26, Sec. 203) 14
Laws of Tennessee, 1895, ch. 160, Sec. 8 (Shannon, Annotated Code of Tennessee (1917), Sec. 3288) 23

Miscellaneous:
2 Holmes, *Federal Taxes* (6th Ed.), p. 728 16
H.Rep. No. 350, 67th Cong., 1st Sess., p. 14 12
Regulations 62, Art. 686 37
Regulations 65, Art. 686 38
S.Rep. No. 275, 67th Cong., 1st Sess., p. 20 12
S.Rep. No. 665, 72d Cong., 1st Sess., p. 36 14

In the Supreme Court of the United States

OCTOBER TERM, 1933

No. 689

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

THE INDEPENDENT LIFE INSURANCE COMPANY

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The findings and opinion of the United States Board of Tax Appeals (R. 15) are reported in 17 B.T.A. 757. The opinion of the Circuit Court of Appeals (R. 48) is reported in 67 F. (2d) 470.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered November 10, 1933 (R. 48). The petition for a writ of certiorari was filed December 29, 1933, and was granted February 5, 1934 (R. 56). The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

Section 245 (b) of the Revenue Acts of 1921 and 1924 provides that life insurance companies may deduct the taxes, expenses, and depreciation upon real estate owned and in any part occupied by them only upon the condition that they include in gross income an amount representing the rental value of the space so occupied. The questions presented are:

1. Whether this condition results in the imposition of a direct tax which is invalid for want of apportionment.

2. Whether the respondent, having availed itself of the privilege extended by the statute, will be permitted to repudiate the condition upon which that privilege is granted.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in Appendix A, *infra*, pp. 35–38.

STATEMENT

The following is a summary of the facts as agreed upon by the parties and found by the Board of Tax Appeals (R. 16–19):

The respondent is a life insurance company with its home office located at Nashville, Tennessee (R. 16).

During the years 1923 and 1924 the respondent owned a twelve-story building in Nashville, of which it occupied about one story as its home office. It rented such portions of the remainder of the

building as it could, and received gross rentals of $73,620.48 and $71,289.21 during the years 1923 and 1924, respectively (R. 16, 18, 19).

In 1923 the taxes, expenses, and depreciation with respect to the building aggregated $70,005.18, and the book value of the building was $460,000 (R. 18). For the year 1924 the taxes, expenses, and depreciation amounted to $85,918.97, and the book value of the building was $494,257.97 (R. 18). In computing its taxable net income for those years the respondent deducted from gross income the taxes, expenses, and depreciation with respect to the building, but failed to include in gross income the rental value of the space occupied by it, as required by Section 245 (b) of the Revenue Acts of 1921 and 1924. The Commissioner determined that the rental value of such space should have been returned as a part of gross income and on January 25, 1927, mailed to the respondent a notice of proposed deficiency assessments for the years 1923 and 1924 in the amounts of $298.97 and $1,115.65, respectively (R. 16). The method by which these deficiencies were computed is shown on pages 18 and 19 of the record.

The Board of Tax Appeals found that the computation of the Commissioner was correct under the law (R. 22), but held that Section 245 (b) of the Revenue Acts of 1921 and 1924 was unconstitutional, and entered an order determining overpayments of $112.86 for 1923 and $226.79 for 1924 (R. 34). Three members dissented on the ground that

the Board is without authority to declare an Act of Congress unconstitutional (R. 33–34).

On December 14, 1932, the Circuit Court of Appeals certified to this Court questions regarding the constitutionality of Section 245 (b) and the right of the respondent to challenge the validity of that section (R. 43–46). On February 20, 1933, the certificate was dismissed, 288 U.S. 592 (R. 47). Thereafter the Circuit Court of Appeals, one judge dissenting, held that the statute was invalid and that the respondent was not estopped to question its validity.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that Section 245 (b) of the Revenue Acts of 1921 and 1924 is invalid.

2. In holding that Section 245 (b) of the Revenue Acts of 1921 and 1924 imposes a direct tax upon real estate.

3. In holding that Congress is without power to limit deductions to those expenses connected with the earning of taxable income.

4. In holding that the tax imposed upon life insurance companies by the Revenue Acts of 1921 and 1924 is not in substance a special excise tax.

5. In holding that the respondent is not estopped to question the validity of Section 245 (b) of the Revenue Acts of 1921 and 1924.

6. In failing to hold that in any event the deductions taken by the respondent under Section

245 (a) (6) and (7) of the Revenue Acts of 1921 and 1924 should be adjusted to give effect, in so far as possible, to the manifest purpose of Congress to permit such deductions only upon the condition and to the extent specified in subdivision (b) of that section.

7. In affirming the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

I

The statute involved, in effect, limits the allowance for expenses of operating a building which is occupied in part by an insurance company to those expenses which are attributable to the portion of the building devoted to the production of investment income. Since no other income is taxed, it was the purpose of Congress to prevent the investment income from being reduced by expenses of producing nontaxable income.

There can be no doubt of the power of Congress to deny or limit deductions, and the legislative history of the statute shows that Congress adopted the present method, after careful consideration, as the most workable method of achieving the desired result. Apparently the way chosen was approved by the insurance companies. As a consequence the statute allows the deduction of the expenses of operating the entire building and accomplishes the limitation by requiring the taxpayer who claims such deductions to report the rental value of the space occupied by it as gross income.

The attack upon the constitutionality of the statute amounts to no more than a criticism of the method by which Congress has exercised an admitted power. The result does not destroy guaranteed exemptions or put a burden upon one entitled to the exemption which he would not otherwise bear, as in *National Life Ins. Co.* v. *United States*, 277 U.S. 508. No direct tax is laid upon rental value of the property. Taxing the rental value is not the object at which the statute is aimed, and the fact that the rental value of space occupied is incidentally and casually affected is immaterial.

The tax upon life insurance companies is not the ordinary tax upon all income but a special tax upon a limited class of income. Despite its inclusion in an income-tax statute it is in the nature of a special excise tax upon life insurance companies. Were it expressly called an excise it would not be invalid because measured in part by something not directly taxable, and no necessity for apportionment would exist. In determining the validity of a statute its form should not control.

The respondent did not except to the action of the Commissioner on the ground that the statute violates the Fifth Amendment, and no sufficient basis for consideration of that question appears in the record.

II

The taxpayer claimed and has received the benefit of deductions which are conditioned upon the inclusion of the rental value in gross income. It

is well settled that one who has received a benefit under a statute will not be heard to assail it. Constitutional questions may be waived as well as others. The application of that rule to this case would result in limiting the deductions in the way Congress intended. On the other hand, if the rule is not applied and the statute is held invalid, the investment income which Congress intended to tax will be reduced by some expenses which contributed to the production of nontaxable income.

If the provision under attack is held invalid, then the provision allowing deductions for real estate expenses must fall, insofar as it applies to home office property, for the provisions are inseparable. Then a life insurance company would be entitled to no deductions for expenses connected with its office building.

ARGUMENT

I

THE PURPOSE AND EFFECT OF THE CHALLENGED STATUTE WERE MERELY TO CORRELATE THE DEDUCTIONS WITH THE LIMITED CLASSES OF INCOME TO BE TAXED. THIS METHOD OF EXERCISING AN ADMITTED POWER DOES NOT CONVERT THE TAX INTO A DIRECT TAX WHICH IS INVALID

The statute here involved has been attacked upon the sole ground that it levies a direct tax which is not apportioned (R. 4, 14, 15). The decision of the Board of Tax Appeals went upon that ground (R. 32, 33). While the court below in terms reserved the question whether Congress might require the inclusion in gross income of the actual or fair rental value of the space occupied and based its decision

on the supposed arbitrariness of the formula prescribed by the statute (R. 51), its reasoning and final conclusion seem to have been the same as those of the Board (R. 50–52).[1] The effect of the decisions below would seem to be to focus attention almost exclusively upon that part of Section 245 (b) which requires the inclusion in gross income of the rental value of space occupied, as though that were the only provision necessary to be considered. It is not enough, we submit, to inquire whether benefit accruing to one who occupies his own building is income within the meaning of the Sixteenth Amendment. Clearly Congress did not intend that it be so regarded, or that it should be taxed as income. Section 245 (b) is but a part of a harmonious plan for the taxation of life insurance companies, drawn with reference to the peculiar nature of their business. When the plan is considered as a whole, it will be seen that Section 245 (b) had as its purpose the correlation of deductions with the limited class of income to be taxed. More specifically, the object of Section 245 (b) was simply to prevent the reduction of taxable income by the expenses of producing nontaxable income.

Considering the statute in the light of this purpose, the Circuit Court of Appeals for the Seventh

[1] It was contended in the court below that the Board of Tax Appeals, as an administrative agency of the Government, is without authority to declare a statute unconstitutional. Three members of the Board dissented on that ground (R. 33). The court below, however, held that there was no necessity for its deciding the question (R. 49).

Circuit recently said in *Commissioner* v. *Lafayette Life Ins. Co.*, 67 F. (2d) 209, 212:

> Accepting as we do this theory of the act and giving full weight to the significant fact that the act limits the taxpayer's right to claim a deduction rather than lays a tax upon the taxpayer, we see no reason for the contention that the act is unconstitutional.

In that case the Circuit Court of Appeals reversed a decision of the Board of Tax Appeals and held that Section 245 (b) of the Revenue Act of 1926 was a valid and constitutional enactment. The pertinent provisions of the Revenue Act of 1926 are the same as those of the 1921 and 1924 Acts here involved, and therefore the decision in the *Lafayette* case supports our position in the case at bar. No application for certiorari was made in that case, but *Commissioner* v. *Rockford Life Ins. Co.*, 67 F. (2d) 213 (C.C.A. 7th), decided at the same time as and upon the authority of the *Lafayette* case, is now pending before this Court, No. 722, October Term, 1933, and is assigned for argument immediately following the instant case.

The end which Congress desired to achieve in adopting this legislation is perfectly apparent. Prior to the Revenue Act of 1921 life insurance companies were taxed upon the same basis as other corporations. This proved unsatisfactory both to the insurance companies and to the Government, and accordingly Congress adopted in the Revenue

Act of 1921 an entirely new plan. In form the tax was an income tax, but it was imposed upon a net income defined with special reference to the peculiar characteristics of the business of life insurance. The term "gross income" was limited to the income received from interest, dividends, and rents; premiums and capital gains were omitted (Sec. 244 (a), Revenue Acts of 1921 and 1924, *infra*, pp. 35, 37), and certain deductions were permitted in computing the net income subject to tax. Among the deductions allowed were taxes paid on real estate and a reasonable allowance for exhaustion, wear and tear, and obsolescence (Sec. 245 (a) (6) and (7), *infra*, pp. 35–36).

Section 245 (b) of the Revenue Acts of 1921 and 1924, which is here brought into question, provides:

> No deduction shall be made under paragraphs (6) and (7) of subdivision (a) on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied.

The petitioner owned a twelve-story building, and during the taxable years 1923 and 1924 occu-

pied one story and rented portions of the remainder. In its tax returns for the years 1923 and 1924 it claimed deductions under Section 245 (a) (6) and (7) but failed to include in its gross income the rental value of the space occupied by it, as required by Section 245 (b) as a condition precedent to taking the said deductions.

By its express provisions Section 245 (b) is applicable only where the taxpayer claims deductions under Section 245 (a) (6) or (7). In such event, Section 245 (b) makes the taking of the deductions conditional upon the inclusion in gross income of the rental value of the space owned and occupied by the taxpayer. The provision in question is thus a limitation upon the deductions. Without such a limitation the whole expense of maintaining the building would be charged against the taxable income, with the result that expenses contributing to the earning of the underwriting income which is not taxed would serve to reduce the investment income which is taxed. There is no compulsion involved, for the taxpayer has an option and is not required to report or account for the rental value of the space occupied by it unless it decides to claim the deductions. In each case an insurance company is free to weigh the practical advantage to it involved in exercising the option provided by the statute.

It is clear from the legislative history of the statute that the aim of Congress was to tax only the *investment* income of life insurance companies,

as distinguished from their underwriting income, and to tax such investment income only to the extent that it exceeded 4 percent of the legal reserves.[2] To avoid distortion of this special class of income, Congress determined to limit deductions to those expenses connected with the earning of the income which was to be taxed, and to deny deductions for expenses in producing underwriting income which was not to be taxed. H.Rep. No. 350, 67th Cong., 1st Sess., p. 14; S.Rep. No. 275, 67th Cong., 1st Sess., p. 20.[3]

The Committee hearings (*infra*, p. 44) show that it was represented to Congress by the Treasury Department, after consultation with the life insur-

[2] Section 245 (a) (2) in terms permits the deduction from gross income of an amount equal to the excess, if any, of 4 percent of the mean of the reserve funds over the interest received on tax-exempt securities. This Court, however, held in *National Life Ins. Co.* v. *United States*, 277 U.S. 508, that the reserve deduction could not be thus limited. Accordingly, the 4 percent is now allowed in full.

[3] The changes in the method of taxing life insurance companies embraced in the Revenue Act of 1921 were worked out after consultation with such companies, and with the approval of most of them, R. 50. See dissenting opinion of Mr. Justice Brandeis in *Nat'l Life Ins. Co.* v. *United States*, 277 U.S. 508, 522. As pointed out in that opinion the provisions in the 1921 Act were based upon the same plan which had been embodied in a Senate Bill in 1918 which was not passed. Section 245 (b) as adopted in 1921 was not contained in the Senate Bill but was included in the 1921 Act following hearings set forth in part, *infra*, p. 39. It appears from those hearings that this portion of the Act, like those included in the rest of the plan, had the approval of the life insurance companies.

ance companies, that it would be impracticable to make a satisfactory apportionment between expenses related to the production of investment income and those related to the production of underwriting income, principally because of the difficulty of determining the rental value of the space occupied by the two departments of the business. Apportionment would be further complicated in those cases where a portion of the building is actually rented to outsiders, thus resulting in the immediate production of investment income in the form of rents.

It is apparent, therefore, that Congress thought, or at least had reason to think, that any system of apportioning the expenses between those applicable to the production of taxable and nontaxable income involved difficulties so great that it would be simpler and more satisfactory[4] to all concerned to use instead the method which was finally adopted.[5] Concededly the deductions thus com-

[4] Apparently the method selected was regarded as satisfactory by the insurance companies for many years, because we are informed by the Treasury Department that no claims for refund of taxes paid were filed until 1929, after the Board declared the section unconstitutional, and that many companies prior to that year had computed their taxes by including the rental value of space occupied by them pursuant to Section 245 (b).

[5] The provisions of Section 245 (b) were continued under the Revenue Acts of 1926, c. 27, 44 Stat. 9 (U.S.C. App., Title 26, Sec. 1004), and 1928, c. 852, 45 Stat. 791. Section 245 (b) of the former and Section 203 (b) of the latter

puted will not, in most cases, represent with complete accuracy the expenses actually attributable to the earning of investment income. It is equally clear, on the other hand, that to permit the deduction of all expenses would bring about a serious distortion of true investment income, especially in

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The provision was substantially changed in the Revenue Act of 1932, c. 209, 47 Stat. 169, Section 203 (b) of which provides (U.S.C. Sup. VI, Title 26, Sec. 203):

> *Rental value of real estate.*—The deduction under subsection (a) (6) or (7) of this section on account of any real estate owned and occupied in whole or in part by a life insurance company, shall be limited to an amount which bears the same ratio to such deduction (computed without regard to this subsection) as the rental value of the space not so occupied bears to the rental value of the entire property.

The change was made in the Senate, and the reasons for it are stated in the Report of the Senate Finance Committee as follows (S.Rept. No. 665, 72d Cong., 1st Sess., p. 36):

> SEC. 203 (b). *Rental value of real estate.*—Under existing law, a life-insurance company is required, as a condition to the allowance of the deductions for depreciation, taxes, and other expenses pertaining to real estate owned and occupied by it, to include in its gross income the rental value of the space occupied by it; such rental value must be not less than a sum which, together with rents from other tenants, will yield a net return of 4 percent of the book value of the real estate. The Board of Tax Appeals has held that this limitation or condition upon the deduction is unconstitutional, and that the company may still deduct the entire amount of depreciation, taxes, and other expenses upon the whole property notwithstanding there is included in gross income, rent from only a part of the property. Without regard to the legality of the present provisions, your committee believes that these provisions would operate somewhat severely in the present depressed condition of real estate, and that it is more equitable merely to disallow so much of these deductions as pertain to the part of the property which is occupied by the company than to allow such deductions in full upon condition of including in

those cases where the company occupies all or a substantial part of the building.[6] The necessity for some adjustment is apparent, and accordingly it cannot be said that the end sought was anything but reasonable. The method selected to achieve that end was one which was at the time conceived by all to be the most practicable. The purpose being a legitimate one, we submit that it was for Congress to determine the means by which it was to be accomplished.

It is settled that no taxpayer is entitled as a matter of right to deductions, and that Congress may deny them altogether or place limitations upon the amounts to be allowed. *Anderson* v. *Forty-Two Broadway Co.*, 239 U.S. 69; *Stanton* v. *Baltic Mining Co.*, 240 U.S. 103; *Von Baumbach* v. *Sargent Land Co.*, 242 U.S. 503; *Clarke* v. *Haberle Brewing Co.*, 280 U.S. 384; *Burnet* v. *Thompson Oil & Gas Co.*, 283 U.S. 301, 304.

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gross income a more or less arbitrary determination of rental value.

The bill as reported accordingly provides for the allowance of a proportionate part of the depreciation, taxes, and other expenses pertaining to real estate owned and occupied by the company, to be determined by the proportion which the rental value of the space not occupied by the company bears to the rental value of the entire property. Such rental value, instead of being fixed by a definite statutory formula, will be determined in accordance with the circumstances in each case.

[6] In the *Rockford Life Insurance* case, No. 722, current term, the company occupied the whole building and claimed the right to deduct all the expenses attributable to the building although it received only $15 in rents during the taxable year (No. 722, R. 13).

The allowance of a deduction only to the extent that it relates to the income which is to be taxed and the denial of such deduction when it does not relate to such income have been held to be within the competency of Congress. *Lewis* v. *Commissioner,* 47 F. (2d) 32 (C.C.A. 3d).

Upon similar principles in *Denman* v. *Slayton,* 282 U.S. 514, this Court held that a diminution of the deduction for interest paid by excluding therefrom interest paid to buy or carry tax-exempt securities was constitutional. As the income from such securities was not included in taxable income, it was held proper not to allow as a deduction the interest paid in order to earn such income.

Also, in the Revenue Act of 1924 Congress adopted the suggestion of the Secretary of the Treasury in his Annual Report for the fiscal year 1922,[7] and amended the provisions limiting the tax on capital gains so as to provide, as an equalizing measure, that the deduction for capital losses should be similarly limited. Section 208 (c), Revenue Act of 1924 (U.S.C., Title 26, Sec. 939). In *Otto Keusch* v. *Commissioner,* 23 B.T.A. 216, it was contended that this provision was unconstitutional, but the section was held to be valid. The Circuit Court of Appeals for the Third Circuit dismissed a petition for review (60 F. (2d) 481), and this Court denied certiorari, 287 U.S. 641.

This process of correlating deductions to the particular income taxed has been applied to state

[7] 2 Holmes, *Federal Taxes* (6th Ed.), p. 728, footnote 68.

income taxes as well. In *Shaffer* v. *Carter*, 252 U.S. 37, it was held that an Oklahoma income tax statute, which in the case of nonresidents reached only their income within the State, might properly disallow as a deduction losses incurred outside the State.

We believe that the determination of the validity of the provision in question does not require consideration of the power of Congress to tax the rental value of property as income.[8] When Section 245 (b) is considered in the light of all of the special provisions for the taxation of life insurance companies, it is clear that it was not the purpose of Congress to tax the rental value of space occupied by the owner. Consideration of such rental value in the return, where the taxpayer elects to obtain the benefit of deductions applicable to the whole building, is merely a convenient method of reducing the amount of a deduction. See dissenting opinion of Judge Tuttle (R. 54–55). It has been held repeatedly that the validity of a tax does not turn upon the yardstick by which it is measured.

Either the Federal or a State government may constitutionally impose an excise tax on corporations for the privilege of doing business in corporate form, and measure the tax by the property or net income of the corporation, including tax-exempt securities or income derived there-

[8] It may be observed that the Supreme Court of Wisconsin has held that the estimated rental value of property occupied by the owner may properly be treated as income for state income tax purposes. *Income Tax Cases*, 148 Wis. 456.

from. *Provident Institution* v. *Massachusetts*, 6 Wall. 611; *Society for Savings* v. *Coite*, 6 Wall. 594; *Hamilton Co.* v. *Massachusetts*, 6 Wall. 632; *Home Ins. Co.* v. *New York*, 134 U.S. 594; *Flint* v. *Stone Tracy Co.*, 220 U.S. 107. Receipts from exports may properly be included in computing a Federal tax (*Peck & Co.* v. *Lowe*, 247 U.S. 165; *Barclay & Co.* v. *Edwards*, 267 U.S. 442), and the measure of a State tax may include receipts from interstate commerce (*U.S. Glue Co.* v. *Oak Creek*, 247 U.S. 321; *Shaffer* v. *Carter*, 252 U.S. 37; *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113).

Upon like principles we think that Congress may constitutionally require a taxpayer to include in gross income the rental value of space occupied by it as a condition to receipt of the privilege of deductions, irrespective of whether it could, under other circumstances, treat the value of such space as taxable income, since it is clear that the process under the present statute is but a means to a lawful end.

This case is unlike *Miller* v. *Milwaukee*, 272 U.S. 713, where there was an attempt to measure the tax by exempt income while excluding from its measure all taxable income. Cf. *Pacific Co.* v. *Johnson*, 285 U.S. 480. In *Miller* v. *Milwaukee*, *supra*, this Court said (p. 715):

> A tax very well may be upheld as against any casual effect it may have upon the bonds of the United States when passed with a different intent and not aimed at them, but

> it becomes a more serious attack upon their immunity when they are its obvious aim.

It is obvious that the provision challenged here was not aimed at the taxation of rental value as such.

Since it is clear that Congress has plenary power to deal with deductions, the challenge of the statute in this case seems to resolve itself into an attack upon the form in which an admitted power was exercised.

Assuming that the end in view otherwise justified the means adopted by Congress, this Court has no concern, of course, with the question whether the means adopted were the wisest or the best calculated to effect the desired result. *Block* v. *Hirsh*, 256 U.S. 135, 158. The power of Congress to limit deductions for interest was challenged in *Flint* v. *Stone Tracy Co., supra*, but this Court held that the tax was not invalid and said (pp. 173–174):

> This provision may have been inserted with a view to prevent corporations from issuing a large amount of bonds in excess of the paid-up capital stock, and thereby distributing profits so as to avoid the tax. In any event, we see no reason why this method of ascertaining the deductions allowed should invalidate the act. Such details are not wholly arbitrary, and were deemed essential to practical operation. Courts cannot substitute their judgment for that of the legislature. In such matters a wide range of discretion is allowed.

The court below relied upon a supposed analogy between this case and *National Life Ins. Co.* v. *United States*, 277 U.S. 508, but in our view that case is distinguishable upon the ground later pointed out in *Denman* v. *Slayton*, 282 U.S. 514. In the *National Life Ins. Co.* case the question was whether Section 245 (a) (2) of the Revenue Act of 1921 could be given effect against the taxpayer to reduce its deduction for reserves by the amount of interest received on tax-exempt securities. The Court said of the effect of the provision involved (p. 519):

> If permitted, this would destroy the guaranteed exemption.

And again (p. 522):

> Congress had no power purposely and directly to tax state obligations by refusing to their owners deductions allowed to others.

In *Denman* v. *Slayton*, *supra*, it was held that the provision denying the right to deduct from gross income interest paid to purchase or carry tax-exempt securities violated no guaranteed exemption because it did not require the taxpayer to pay more upon his taxable receipts than was demanded of others solely because he was in receipt of interest from tax-free securities, and the *National Life Ins. Co.* case was distinguished on that ground. We submit that the instant case may be distinguished on similar principles. The distinction made here is not between taxpayers earn-

ing exempt income and others earning taxable income. The distinction is between taxpayers who claim allowances for the expenses of producing taxable income only, and taxpayers who seek to reduce taxable income by the expenses of producing income which is not taxed. We submit that the thing really taxed in this case is the income from interest, dividends, and rents less the allowances permitted by the statute, and that the limitation of the allowance by a formula designed to exclude the expenses of producing nontaxable income is not invalid.

In *Evans* v. *Gore*, 253 U.S. 245, and *Miles* v. *Graham*, 268 U.S. 501, also relied upon by the court below, the point was that not only were the judges required to return their exempt compensation as gross income, but they were taxed upon this amount as upon other salaries or income received. There was no compensating deduction in those cases. Surely it would not have been contended that, had the salary been included in the gross income and then provision been made for a compensating deduction of a larger amount, there could have been any occasion for complaint on the theory that the exempt salary was taxed as such.

This is not shown to be a case where the taxpayer is required to pay a larger tax than would be due if it did not occupy its own building. It is clear that if it had rented to others the space occupied

by it its rental income would have been increased accordingly. It is probable, too, that if the space occupied by it had remained vacant the expenses of maintaining the building would have been less than reported. All of these factors enter into the computation of the tax, and it has not been shown that the challenged provision places any burden upon the taxpayer from which others similarly situated are free. Of course, it is not necessary that the statute shall secure exact equality among taxpayers, for this Court has pointed out in *Metropolis Theatre Co.* v. *Chicago,* 228 U.S. 61, 69–70, that "The problems of government are practical ones and may justify, if they do not require, rough accommodations—illogical, it may be, and unscientific."

Section 245 (b) had another purpose, in addition to that of correlating expenses with the limited class of income to be taxed. Section 245 (a) (2) provides for the deduction from gross income of 4 percent of the mean of the reserves at the beginning and end of the taxable year. The object of that provision was to exclude from taxable income that portion of the interest, dividends, and rents received which must be "used each year in maintaining the reserve, *i.e.,* adding to it on the basis of a certain interest rate, varying from 3 per cent to 4 per cent according to the requirements of the statutes of the several States." *National Life Ins. Co.* v. *United States,* 277 U.S. 508, *supra;* p. 525

(dissenting opinion).[9] But the reserve funds of life-insurance companies are commonly invested in home-office property as well as in securities. See Hearings, *infra,* p. 47. To the extent, therefore, that the home-office building is occupied by the underwriting departments of the company, the assets held in reserve contribute nothing to the maintenance of the reserve, and the allowance of a deduction of 4 percent in respect of the reserves represented by the building is illogical and out of place. Thus in the instant case, if it is proper to assume, as we think it is, that the home-office property constituted a part of the respondent's assets held as a reserve against policy obligations, we find the situation to be that the respondent receives a deduction of 4 percent on account of the building although the building gives a net return of considerably less than 4 percent. Moreover, this is in addition to the deduction allowed, under the decision below, on account of the expense of maintaining that part of the building which produces no investment income. The Hearings (*infra,* p. 47) show that those who drafted Section 245 (b) had this situation in mind, and that one purpose of that section was to correct the distortion resulting from the allowance of the 4 percent reserve deduction in circumstances such as are present here.

[9] The statutory rate in Tennessee, the State in which the respondent was incorporated, is 4 percent. Laws of Tennessee, 1895, ch. 160, sec. 8. (Shannon, Annotated Code of Tennessee (1917) Sec. 3288).

There is a further reason for concluding that the tax involved is not invalid. This Court has pointed out that the Federal income tax acts cover taxes of different classes, and that in some of their aspects the taxes laid are excise taxes. *Willcuts* v. *Bunn,* 282 U.S. 216, 227. It is obvious that the tax upon life insurance companies is not the usual income tax upon the entire net income. It is a tax upon only a selected portion of the income. The insurance companies do not account for premium receipts or capital gains, but only for income from investments, and the deductions are not those designed to arrive at net income in the ordinary sense. The tax thus imposed may, we submit, be regarded as being in substance, if not in form, a special excise tax. It was so considered in the dissenting opinion of Mr. Justice Brandeis in *National Life Ins. Co.* v. *United States,* 277 U.S. 508, *supra,* p. 522, and was not expressly characterized otherwise in the majority opinion.

If the tax in respect of life insurance companies were designated an excise tax, imposed on the privilege of doing business, we submit it would not be invalid because measured in part by the rental value of property used in the conduct of the business. The power of Congress to include in the measure of an excise things which could not be taxed directly is well settled. See *Pacific Co.* v. *Johnson,* 285 U.S. 480; *Educational Films Corp.* v. *Ward,* 282 U.S. 379; *Blodgett* v. *Silberman,* 277 U.S. 1; *Greiner* v. *Lewellyn,* 258 U.S. 384; *Flint* v. *Stone*

Tracy Co., 220 U.S. 107. Moreover, an excise need not be apportioned, but need only be geographically uniform. *Flint* v. *Stone Tracy Co., supra; Bromley* v. *McCaughn*, 280 U.S. 124; *Patton* v. *Brady*, 184 U.S. 608, 622.

Proper application of the presumption of the validity of legislation requires that regard be had for the substance of the thing accomplished and that its form should not control. In substance the statute levies no tax on real estate, since in any case in which the deductions are claimed they will exceed the rental value of the space occupied by the taxpayer; otherwise the taxpayer would not elect to take them, knowing the condition upon which they are granted. We submit that the purpose and effect of the Act are merely to limit allowable deductions, that the means adopted have a reasonable relation to the end in view, and that no attempt is being made to levy a direct tax which is invalid for want of apportionment.

As heretofore pointed out, the sole attack upon the tax has been upon the ground that it is a direct tax, and no claim has been made that the statute is invalid under the Fifth Amendment. While we believe that the statute is not open to attack upon that ground, it is apparent that the present case does not admit of consideration of any such question.

Since the question was not raised, the record has not been prepared to meet a contention that the

tax is arbitrary or capricious. It cannot be assumed, as was done by the court below (R. 51), that the difference between the rental values for the two years was due solely to the application of an arbitrary formula. A change in any one of the factors used in computing the rental value would produce a different result. The record clearly shows that in 1924 the expenses increased over 1923 by nearly $16,000, while the rents received from others were $2,300 less in 1924 than in 1923. The only factors which remained constant were taxes and depreciation. Neither can it be assumed that the 1923 figure for rental value is normal, nor that the 1924 figure is excessive. For all this record shows, the figure for 1923 may be less than the actual rental value and the figure for 1924 may be its substantial equivalent. It is to be observed, also, that the gross return on the book value of the building, aside from the value of the space occupied by the respondent, was more than 16 percent in 1923 and slightly less in 1924, and that in spite of this large return the expenses in 1923 nearly equaled the actual gross receipts and in 1924 exceeded them.

In view of the peculiar nature of the tax upon insurance companies, it is obvious that the question whether the requirement that there be included in gross income the rental value of space occupied by the owner in an amount sufficient to provide a net return of 4 percent of the book value of the building, is arbitrary and capricious in its practical operation would require consideration of many

factors, none of which are before the Court in this case. Among others, the factors to be considered would seem to be the extent of the deduction for reserves and the value to be placed upon the space occupied by the owner, apportioned between the space used for producing taxable investment income and that used in the production of nontaxable underwriting income. This would require a consideration of many elements in the taxpayer's business and a complete analysis of the investment and underwriting income and the methods by which it was earned. If computation of the rental value of space occupied by the owner resulted in a different figure in two or more different years, analysis of any changes in expenses, book value, and rentals paid by others would seem to be necessary in order to determine whether a change in the actual rental value of the taxpayer's space had occurred and whether any of the elements which enter into the computation of rental value under the statute ought, because of the peculiar circumstances of the particular case, to be given a new or special weight in the computation.

Thus, even if the question had been raised by the respondent, we believe that it would be quite impossible, upon the meager facts before this Court, to determine whether, as applied to this taxpayer, the statute was arbitrary or capricious. Decision of constitutional questions cannot be made in the absence of facts disclosing the reason for the enactment and the effects of its operation. See *O'Gor-*

man & Young, Inc., v. *Hartf'd Ins. Co.*, 282 U.S. 251; *Insurance Co.* v. *Glidden Co.*, 284 U.S. 151, 158; *Boston & Maine R. Co.* v. *Armburg*, 285 U.S. 234. Accordingly, we believe that the record should be considered as limiting consideration of constitutional objections to the contention of the respondent in the Board of Tax Appeals that the statute imposes a direct tax which is invalid for want of apportionment.

II

THE STATUTE ALLOWS THE DEDUCTIONS UPON A CONDITION: RESPONDENT WILL NOT BE HEARD TO RELY UPON THE GRANT OF THE ALLOWANCES AND AT THE SAME TIME TO ASSAIL THE CONDITION

If the statute is construed, contrary to our contention, as being expressly laid upon the rental value of the space occupied by the respondent in its own building, nevertheless we submit that the respondent should not be permitted to recover. The respondent invited the application of Section 245 (b) by claiming the deductions, and this case therefore suggests the application of the well-settled rule that one who voluntarily accepts the privileges and benefits of a statute will not be permitted to repudiate the burdens attached by it to the privilege claimed. This Court recently declared, in *Frost* v. *Corporation Commission*, 278 U.S. 515, 527:

> It is not open to question that one who has acquired rights of property necessarily based upon a statute may not attack that

statute as unconstitutional, for he cannot both assail it and rely upon it in the same proceeding.

The same principle has found application in numerous circumstances. Thus, it has been held that one cannot invoke the aid of a statute conferring jurisdiction and at the same time attack the validity of the statute so invoked. See *United Gas Co.* v. *R. R. Commission,* 278 U.S. 300, 307–308; *Wall* v. *Parrott Silver & Copper Co.,* 244 U.S. 407; *Electric Co.* v. *Dow,* 166 U.S. 489; *Great Falls Mfg. Co.* v. *Attorney General,* 124 U.S. 581, 598–599. Similarly, a property owner who has availed himself of the benefits arising from street or sewer improvements may not sue to cancel his tax bill on the ground that the manner of apportioning the cost of the improvements violated his rights under the Fourteenth Amendment. See *St. Louis Co.* v. *Prendergast Co.,* 260 U.S. 469. See also *Wight* v. *Davidson,* 181 U.S. 371. In *Booth Fisheries* v. *Industrial Commission,* 271 U.S. 208, an employer who had elected to be bound by a workmen's compensation act and who had accepted the benefits and immunities conferred by that act was held to be precluded from questioning its constitutionality on the ground that it deprived him of the right of full judicial review.

It is well established that corporations may not, in general, challenge the validity of provisions imposed upon them by a State as a condition of their

incorporation. See *Pierce Oil Co.* v. *Phoenix Rfg. Co.*, 259 U.S. 125; *International & G. N. Ry. Co.* v. *Anderson Co.*, 246 U.S. 424; *Interstate Railway Co.* v. *Massachusetts*, 207 U.S. 79; *Grand Rapids & Indiana Ry Co.* v. *Osborn*, 193 U.S. 17; *Hancock Mutual Life Ins. Co.* v. *Warren*, 181 U.S. 73; *Waters-Pierce Oil Co.* v. *Texas*, 177 U.S. 28; *Horn Silver Mining Co.* v. *New York*, 143 U.S. 305. See also *Railway Express Co.* v. *Virginia*, 282 U.S. 440. Likewise, acceptance of a franchise has been held to bar a subsequent contention that the grant from the State entailed an unconstitutional burden in addition to the privilege sought and obtained. See *Fox River Co.* v. *R. R. Commission*, 274 U.S. 651, 657; *Southern Utilities Co.* v. *Palatka*, 268 U.S. 232; *Columbus Ry. & Power Co.* v. *Columbus*, 249 U.S. 399.

The allowance of deductions from taxable income, like the grants of privileges or immunities or extensions of benefits involved in the cases cited above, is a matter of legislative sufferance or permission. A reasonable condition attached to the allowance should not be open to question by one who has claimed the deduction allowed.

In the case at bar it is complained that the statute requires the taxpayer to include the rental value of the space occupied by it in its own building as income, which is alleged to result in an unconstitutional tax. But the provision of which complaint is made is applicable to the company only because it has itself taken the benefits of the

deductions upon which the operation of the challenged provision depends. If the deduction had not been made, the provision would by its own terms have been inapplicable. That a very real benefit has been obtained by the company's election to invoke the statute is apparent from consideration of the facts appearing in the record. Under the statute the taxpayer has obtained total deductions of $70,005.18 for 1923 and $85,918.97 for 1924 (R. 18). The present suit involves a tax upon only $14,784.70 for 1923 (R. 18), and upon $34,400.08 for 1924 (R. 19). The benefits secured, it is apparent, are substantial. It is clear that the consideration moving from the taxpayer to obtain them is not a disproportionate one; and, since it is unquestioned that to withhold any deduction whatsoever was wholly within the competence of Congress, it cannot be maintained that the consideration was exacted under duress.

We submit that the court below erred in saying that the respondent "accepted no benefits under Section 245 (b) of either act" (R. 52). Subdivision (b) qualifies subdivisions (a) (6) and (a) (7), extending to the taxpayer the privilege of taking the deductions there specified (in respect of home office property) only upon the condition stated. When read together, as they must be, these provisions have precisely the same meaning as if home office property had been expressly excluded from (a) (6) and (a) (7) and separate provisions had been made for such property in subdivi-

sion (b). It would then have been abundantly clear that the privilege and the condition were so inseparable that the taxpayer could not have the benefit of the one without assuming the burden of the other. But the legislative purpose is so apparent that the form of the act should not, we submit, inhibit its fulfillment.

Frost v. *Corporation Commission*, 278 U.S. 515, *supra*, is not opposed to our contention as the court below held (R. 52). The appellant there was challenging the validity of a proviso which had been added some years after the enactment of the statute. The Court held that the rule of estoppel did not apply because the proviso was separable from the provisions which it qualified, having been enacted later, and consequently the appellant could claim rights under the original Act without regard to the invalid amendment. Here all the provisions were enacted at the same time and formed part of a harmonious whole. The rights of the respondent do not owe their existence solely to Section 245 (a) (6) and (7), for the privilege there granted was expressly qualified and limited by Section 245 (b). Those paragraphs together constitute the statutory provisions relative to the deduction of expenses having to do with real estate. Accordingly, the *Frost* case is not in point, and we submit that the circumstances here are such as to preclude the respondent from rejecting one part of the section while relying on another part.

In any event, the interdependence of these provisions would seem to call for a readjustment of the respondent's tax liability, because subdivisions (a) (6) and (7) of Section 245, insofar as they relate to home-office property, cannot stand if subdivision (b) is held invalid. While the Act contains the usual saving clause (Section 1403), that does no more than create a presumption that "eliminating invalid parts, the legislature would have been satisfied with what remained." *Champlin Refining Co.* v. *Corporation Commission,* 286 U.S. 210, 235. This presumption may be overcome by "considerations that make evident the inseparability of the provisions or the clear probability that the legislature would not have been satisfied with the statute unless it had included the invalid part." *Utah Power & Light Co.* v. *Pfost,* 286 U.S. 165, 184–185. We submit that such clear probability exists here. If the Court should strike down subdivision (b) but still hold the respondent entitled to the deductions claimed, the taxable investment income would obviously be distorted. Without the limitation expressed in that subdivision the deductions for real estate expenses, insofar as they include home-office property, are entirely inappropriate and out of line with the plan of taxation, and it is extremely improbable that Congress would have granted any deductions at all in respect of such property had it been advised that the limitation was invalid.

The distortion of taxable income which would result from the separation of these provisions is strikingly illustrated by *Rockford Life Ins. Co.* v. *Commissioner,* No. 722. The taxpayer there occupied the entire building, returning only $15 rental income therefrom. Nevertheless, it claims deductions for taxes, depreciation, and repairs, aggregating ~~$3,003.05~~ $83-05. (No. 722, R. 13.)

CONCLUSION

We submit that the provision requiring insurance companies to report the rental value of space occupied by them does not impose a direct tax and that the selection of this method of limiting deductions is not open to question.

In any event, we submit that the taxpayer, having received the benefits conferred by Section 245 (a) (6) and (7), should not be permitted to repudiate the condition upon which those benefits were granted.

For these reasons, the decision of the Circuit Court of Appeals should be reversed.

Respectfully submitted.

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APPENDIX A

Revenue Act of 1921, c. 136, 42 Stat. 227, 261, 262:

SEC. 243. That in lieu of the taxes imposed by sections 230 and 1000 and by Title III, there shall be levied, collected, and paid for the calendar year 1921 and for each taxable year thereafter upon the net income of every life insurance company a tax as follows:

(1) In the case of a domestic life insurance company, the same percentage of its net income as is imposed upon other corporations by section 230;

* * * * *

SEC. 244. (a) That in the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.

* * * * *

SEC. 245. (a) That in the case of a life insurance company the term "net income" means the gross income less—

* * * * *

(2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium

payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

* * * * *

(6) Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. The deduction allowed by this paragraph shall be allowed in the case of taxes imposed upon a shareholder or member of a company upon his interest as shareholder or member, which are paid by the company without reimbursement from the shareholder or member, but in such cases no deduction shall be allowed the shareholder or member for the amount of such taxes;

(7) A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence. In the case of property acquired before March 1, 1913, this deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913;

* * * * *

(b) No deduction shall be made under paragraphs (6) and (7) of subdivision (a) on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the

return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied.

Revenue Act of 1924, c. 234, 43 Stat. 253, 289:

[Sections 243 (U.S.C., Title 26, Sec. 1001), 244 (U.S.C., Title 26, Sec. 1003), and 245 (U.S.C., Title 26, Sec. 1004) contain provisions substantially the same as those of the corresponding sections above quoted.]

Treasury Regulations 62:

ART. 686. *Home office properties.*—No deduction shall be made for any taxes, expenses, or depreciation on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall not be less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and other expenses) at the rate of 4 percent per annum of the book value at the end of the taxable year of the real estate so owned and occupied. For example, if the book value of a parcel of real estate owned and occupied in whole or in part by the company is $1,000,000, the rents received from other tenants $30,000, taxes and expenses $40,000, and depreciation $20,000, the company would have to include in its gross in-

come a sum not less than $70,000 ($40,000 taxes and expenses, plus $20,000 depreciation, minus $30,000 rents from tenants, plus 4 percent of $1,000,000) as the rental value of the space occupied by it in order to avail itself of the deductions of $40,000 and $20,000. In any case the rents received from other tenants must be included in gross income.

Treasury Regulations 65:

[Article 686 is substantially the same as the corresponding article set forth above.]

APPENDIX B

Extracts from hearings before Committee on Finance on H.R. 8245, 67th Cong., 1st Sess., pp. 83–84, 88, 91–93:

Doctor ADAMS. Mr. Chairman, we left off at page 93, section 242.

Gentlemen, the scheme in general in section 242 is this: It is to apply a tax on life insurance companies to make it applicable to investment income. Under the present law the premiums paid by a life insurance policyholder are deemed to be actual income by the life insurance company.

Senator MCCUMBER. How is that?

Doctor ADAMS. The ordinary annual premium that you pay on a life insurance policy is the basis of the income of a life insurance company, although no deduction can be made for it by the individual policyholder. It is regarded as a capital transaction to him. He makes no deduction for his life insurance premium payment, but the company when it gets it must regard it as income.

That being a starting point—and I think it is a false starting point—we have to authorize a lot of special and highly unscientific deductions, with the result that the taxation of life insurance companies is one of the faultiest parts of the income tax act. There is a continual litigation over insurance companies' taxes because of the method of taxation.

It has been suggested—and I think it is obviously sound—that the only true basis

of income of a life insurance company is its investment income—interest, dividends, and rents which it receives. The premium payments it gets are a good deal like a bank deposit. When it takes them over, it creates an obligation such as the obligation of a bank to return a deposit when it is called for. So that is omitted altogether. You start with the investment income, and certain deductions have been worked out with the result that the life insurance companies will pay very much more taxes under the proposed scheme than they did before.

At the same time, there was on the life insurance companies a special tax of 8 cents on the amount of new business written. That is in Title V. It is one of the special excise taxes. And with the adoption of this new method it was proposed, and the House indorsed the proposal, to wipe out all other taxes on insurance companies; that is to say, this 8 cents on new business and the capital stock tax, which involves special difficulties when applied to mutual insurance companies, and most of them are mutual; they have no true capital stock.

The CHAIRMAN. Doctor, did they have a hearing before the House committee?

Dr. ADAMS. They did not have a hearing, Mr. Chairman. This matter was worked out really so satisfactorily in the revenue act of 1918, when the life-insurance companies had gotten together, that they have not appeared before the committees, but have come to me and asked me if we could take this other scheme. I was personally very well satisfied with it, because if you adopt a 15 percent rate, or if the 15 percent income-tax

rate originally proposed had been adopted, we would get more under that 15 percent tax with the new scheme of taxation than under all the others combined. I am not certain that the 12½ percent rate will do that. I think it will leave us a little less than we had before. But the scheme would have been infinitely simpler, and we would have avoided this continual litigation.

Senator McCUMBER. Will you repeat again just how you propose to tax them?

Dr. ADAMS. The scheme of taxation starts by defining their gross income as investment income, namely, their incomes from dividends, rents, etc. Then there are recorded against that certain deductions, which I will read.

Senator McCUMBER. And that is satisfactory to both the mutual and the old-line companies?

Dr. ADAMS. All the life-insurance companies are behind that scheme and are satisfied with it.

* * * * *

The CHAIRMAN. I know that you are so saturated with the thing that what seems plain to you is still obscure to us. In the last bill there was nothing that we had more contention over than this insurance provision, owing to the peculiar attitude of Mr. Kitchin, and probably every insurance man in the United States of any prominence was down here to see members of the committee. It has been different this year. Not one has been to see me; so it must be satisfactory to them.

Dr. ADAMS. Senator, I shall follow and shall be only too glad to follow the suggestions made.

Senator SIMMONS. You say this is probably what we had in the Senate bill before and they come down here and had long conferences with Dr. Adams and others and they agreed to that. Now, after it has been put in by the House, as the House was the stumbling block before, I take it that they think it will meet with no trouble in the Senate because we passed it once.

* * * * *

The CHAIRMAN. Doctor, is not the allowance for obsolescence rather unusual?

Dr. ADAMS. That is checked immediately below. It would be unusual except for this purpose: Where property is held as a part of the investment of the company, and they are obviously entitled to a deduction for the obsolescence depreciation against that part of the property. Obsolescence is not special to insurance companies. We mention it in connection with depreciation allowance to other taxpayers. That is exactly the same verbiage as applies to other taxpayers.

The CHAIRMAN. It refers to property held by the insurance companies?

Dr. ADAMS. Yes; and for investment. You will see that this is limited and circumscribed in the section that I am about to read:

"(b) No deductions shall be made under paragraphs (6) and (7) of subdivision (a) on account of any real estate owned and occupied in whole or in part by an insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the

rate of 4 percent per annum of the book value at the end of the taxable year of the real estate so owned or occupied."

Now, the thought there is this: Insurance companies very frequently invest a large portion of their funds in a building which they themselves occupy. That is an investment of a peculiar kind. It yields no income except as it saves them the rental expenditure. Where that is true, the companies acquiesce in this provision that they shall not have deduction for real-estate taxes, or that they shall not have deduction for depreciation unless they put the estimated investment income from that building back into their income. You see that it is a sort of a silent income. It is income only by saving them what they would have to spend if they did not put their money in that building.

Senator SIMMONS. That is where they use the building only for the purpose of carrying on another business than insurance?

Dr. ADAMS. Yes.

Senator SIMMONS. But where they rent and use a part of that building——

Dr. ADAMS. That is taken care of in this provision, because it says that you have to actually get in income 4 percent of the capital invested in that building, and unless you have that much you cannot take a deduction for taxes or a deduction for depreciation, but if you have that much you may take those deductions. And you may also take those deductions in case of real estate which you own and rent to other people.

Senator MCCUMBER. Now, tell me, Doctor, why the necessity for all that complexity? Why could not you compel the company to make a return for all income received, whether it was an investment in a building or otherwise, and then allow them to deduct

their taxes on that building, which gives them a net of what they received on the building? What is the use of that 4 percent and an addition? They have invested.

Dr. ADAMS. They may occupy, as I know one insurance company does, all the floors except the first and second and third. They occupy 11 floors. They may rent part or the whole. In getting at their occupancy, a large part of which is estimated rental value, there would be innumerable difficulties, which we would dispute and haggle about. Estimated rental value is very difficult to get at.

Senator MCCUMBER. What is the use of charging them off rent they do not pay? As long as they have their capital invested in so many floors, and they are occupying them, they do not have to pay that sum out, and consequently they receive that much more. Their gross income would be that much more, and their net income would be that much more, and you tax their net income. What is the use of dividing that into a 4 percent proposition and having all these complexities?

Dr. ADAMS. I was trying to explain that. Your solution of it was the solution that I suggested originally. It is the result of long conferences and lot of thought and care. I said to these gentlemen, "Why take your deductions for taxes on real estate which you occupy? Why put in your income from real estate which you occupy, your estimated income?" They convinced me that it would be more satisfactory to do it that way—more accurate. After our investigation I was satisfied of the correctness of their views in the case of some of these enormous New York build-

ings, like the Metropolitan Building, Twenty-third and Broadway, New York.

The CHAIRMAN. Any of those large buildings.

Dr. ADAMS. The thing does not check out. It is more accurate to go through the roundabout process of allowing them the depreciation and deduction. This estimate of rental value is a terrifically difficult thing. It is difficult for us; it is difficult for anybody to estimate what the rental value of a building is where it is not actually rented to somebody else. In order to cover that situation it is necessary to say that unless they are actually renting to somebody and by contract getting the money we will put in a limitation and assume they are receiving at least a certain amount net for it.

Every word of the phraseology of that section has been gone over by insurance experts of the very highest caliber. Only a few people are involved. The public is not interested in this. They do not have to read it, and the people who deal with it are experts. Every word of that phraseology was presented to the insurance officials, and only those companies who are involved must understand it. Of course, you gentlemen must understand it, as long as you have to pass upon and approve it. You people have an understanding that the outside public does not have to have.

Senator MCCUMBER. But suppose a company is organized to do a mercantile business, puts up its own building, invests so much of its own capital, and it occupies a certain number of stories in that building and rents the others. If they invest capital in a place to live in, a place to do business in, they do not have to pay rent. They save

that much. You compel them to make a return of what they receive for rent of a certain portion of that building?

Dr. ADAMS. Yes.

Senator MCCUMBER. Just the same as any other line of business. Why should that not apply equally to insurance companies?

Dr. ADAMS. The reason for that is that you have a situation with insurance companies which does not apply to any other companies. A great part of their business is nontaxable. They put up a building costing fifteen or twenty million dollars. Nineteen twentieths of it may be used for the transaction of the nontaxable part of their business. There is where that difficulty has arisen. Nineteen twentieths of it may be used for the purpose of collecting premiums and paying losses, to which we are now paying no attention. That is the nontaxable end of their business. Perhaps only one half of one floor is given to the investment business, which is the taxable end of their business.

They would come along and say they had a certain depreciation deduction on certain taxes they paid. We would have to go through some kind of prorating process to say how much depreciation there should be and how it would be taxable, as assigned to the taxable or investment end of their business. To avoid that this plan is used. You cannot base deduction on all the taxes; you cannot base depreciation on all the taxes without some limitation, because we must get some generally just and equitable method of prorating those deductions.

Senator SIMMONS. I do not know that I understand this question; and I will state to you my understanding of it, and ask you if I am correct.

This means they shall not be entitled to the deductions provided in paragraphs 6 and 7 where they occupy a part of the building, unless they include in their gross income return the value of the space so occupied. Now, in order to fix the value of that space, you take the rents they receive from other tenants, and you add to that a sum which will make an annual return for that property of 4 percent.

Dr. ADAMS. Four percent. There is another purpose there that is very essential, and that is this: You are giving these companies a deduction of 4 percent on their reserve fund. Their reserve funds are invested in this building. You are giving them a deduction of 4 percent once, through the 4 percent reduction against reserve funds. You do not want to give them that again. You take the rent which they get and deduct the depreciation from it, and the remainder should not be less than 4 percent upon the capital invested.

Senator SMOOT. Suppose it is more than 4 percent?

Dr. ADAMS. All right; if it is more than 4 percent, we are willing to do it, but it will not be less than that, because they have already had that deduction.

Senator SMOOT. If it is more, we would want the difference over and above it.

Senator SIMMONS. Four percent is a very small return upon real estate.

Senator SMOOT. I do not think so.

Senator SIMMONS. You do not?

Senator SMOOT. I do not think there is any real estate in the United States, with all expenses and depreciation paid, which will net 4 percent.

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